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No. 06-480

IN THE

Supreme Court of the United States

LEEGIN CREATIVE LEATHER PRODUCTS, INC.,
Petitioner,

v.

PSKS, INC., doing business as Kay's Kloset . . . Kay's Shoes,
Respondent.

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On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Fifth Circuit

REPLY BRIEF FOR PETITIONER

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RULE 29.6 STATEMENT

The corporate disclosure statement included in the petition for a writ of certiorari remains accurate.

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REPLY BRIEF FOR PETITIONER

Nothing in PSKS's Opposition Brief diminishes the stark conflict between *Dr. Miles*' antiquated *per se* rule against resale price maintenance and this Court's modern antitrust jurisprudence, which restricts the use of *per se* rules to practices that "*always* or *almost always* tend to restrict competition and decrease output." *Broadcast Music, Inc. v. Columbia Broadcasting Sys., Inc.*, 441 U.S. 1, 19-20 (1979) (emphases added). PSKS makes no attempt whatsoever to demonstrate that resale price maintenance always or almost always reduces competition. Rather, PSKS argues that resale price maintenance is not universally procompetitive because there are some "anticompetitive explanations for resale price maintenance." Opp. at 16. This Court has repeatedly made clear, however, that the mere possibility that a practice may lead to anticompetitive effects in some circumstances is not a sufficient basis for establishing a *per se* prohibition. *See Broadcast Music, Inc.*, 441 U.S. at 19-20; *see also State Oil Co. v. Khan*, 522 U.S. 3, 10 (1997) ("we have expressed reluctance to adopt *per se* rules . . . where the economic impact of certain practices is not immediately obvious" (internal quotation marks omitted)).

Similarly, PSKS makes no effort to suggest that the rule of reason would invariably—or even frequently—condemn resale price maintenance. *See Khan*, 522 U.S. at 10 (a *per se* rule is only appropriate "once experience with a particular kind of restraint enables the Court to predict with confidence that the rule of reason will condemn it"). The effect of PSKS's approach would be to condemn a significant amount of activity that could enhance competition and benefit consumers—such as Leegin's use of resale price maintenance in this case—regardless of the economic effect of the practice. Indeed, PSKS argues that the "legal standards governing vertical conduct" should not be based on "economic analysis." Opp. at 19-20. In *Sylvania*, however, this Court explicitly rejected the approach that PSKS advocates, holding instead

that a "departure from the rule-of-reason standard must be based upon demonstrable economic effect rather than ... upon formalistic line drawing." *Cont'l T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 58-59 (1977); *see also Bus. Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717, 724 (1988). That PSKS is forced to rely on such an argument to defend the rule of *Dr. Miles* merely underscores the conflict between that rule and this Court's decisions in *Sylvania*, *Sharp*, and other modern cases. That conflict is itself reason to grant Leegin's petition and re-examine the rule of *Dr. Miles*.

A. PSKS's Argument About A Purported Horizontal Cartel Is A Red Herring, Which PSKS Raised For The First Time In Its Opposition Brief.

PSKS's primary argument in its Opposition Brief is that the Court should disregard the fundamental legal and economic flaws in the rule of *Dr. Miles* because this case supposedly involves a horizontal cartel. Opp. at 1-8. PSKS's attempt to raise this argument at this late stage of the litigation is surprising because PSKS has never once—not in the district court, not in the Fifth Circuit, and not in its opposition to Leegin's application to stay the Fifth Circuit's mandate—argued that *per se* treatment is appropriate for any reason other than *Dr. Miles*' *per se* prohibition of vertical resale price maintenance agreements. Not surprisingly, the courts below did not address this newly minted horizontal theory, but rather based their holdings on the rule of *Dr. Miles*.[1] This case thus squarely presents the question of the viability of *Dr. Miles*, and the Court should reject PSKS's transparent

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[1] The district court denied Leegin's motion for judgment as a matter of law or for a new trial based on the rule of *Dr. Miles*. *See* Pet. App. at 12a ("Nearly a century ago, *Dr. Miles* prescribed vertical minimum price fixing agreements unlawful under Section 1. Whether the per se classification of such agreements is wise is not for this court to decide." (citation omitted)). Likewise, the Fifth Circuit affirmed based on the rule of *Dr. Miles*. *See* Pet. App. at 4a ("Because the Court has consistently applied the *per se* rule to [vertical minimum price-fixing agreements], we remain bound by its holding in *Dr. Miles Medical Co.*").

and belated attempt to recharacterize this case as being about something other than a vertical restraint.

Even if PSKS had raised this issue below, there is no support for its suggestion that a restraint on intrabrand retail competition established by a dual-distributing manufacturer should be subject to the *per se* rule against horizontal restraints. To the contrary, this Court and numerous courts of appeals have rejected attempts to characterize such arrangements as *per se* unlawful horizontal agreements.[2]

In addition, there is no reason for Leegin to organize a cartel among its retailers, which (assuming a cartel in this fragmented retail marketplace could even be maintained) would have the effect of boosting retail margins and reducing the volume of its own sales.[3] Moreover, in the diverse mar-

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[2] In *White Motor Co. v. United States*, 372 U.S. 253 (1963), which involved territorial and customer restrictions by a dual-distributing manufacturer, *id.* at 255, the Court treated the restrictions as involving a "vertical arrangement," *id.* at 261, rejecting the Government's argument that the restrictions should be treated as a horizontal arrangement. Similarly, in *United States v. Arnold Schwinn & Co.*, 388 U.S. 365 (1967), although Schwinn sold bicycles through a dual distribution system, including sales to wholesale distributors for resale to retailers and direct sales to retailers in competition with its distributors, *id.* at 370, the Court noted that "[w]e are here confronted with challenged vertical restrictions as to territory and dealers. The source of the restrictions is the manufacturer. These are not horizontal restraints . . . ." *Id.* at 372. Numerous post-*Sylvania* decisions have likewise treated distribution restraints established by a supplier engaged in dual distribution as vertical. *See, e.g., Smalley & Co. v. Emerson & Cuming, Inc.*, 13 F.3d 366, 368 (10th Cir. 1993); *Ill. Corp. Travel v. Am. Airlines, Inc.*, 889 F.2d 751, 753 (7th Cir. 1989); *Int'l Logistics Group, Ltd. v. Chrysler Corp.*, 884 F.2d 904, 906 (6th Cir. 1989); *Ryko Mfg. Co. v. Eden Servs.*, 823 F.2d 1215, 1230-31 (8th Cir. 1987).

[3] As Judge Easterbrook recently observed in affirming summary judgment against a dealer who alleged that a manufacturer had organized its dealers into a retail cartel, "[p]roducers gain when the costs of distribution are lowest; a retail cartel that charged a monopoly price for distribution services would hurt [the manufacturer] as well as (if not more than) ultimate consumers, so it is a surprise to see [the manufacturer] ac-

ketplace for women's fashion accessories, any effort to promote supracompetitive profits for retailers of Leegin's goods would simply divert consumer traffic to the numerous other brands that are sold in countless other outlets.[4] Contrary to PSKS's unsupported cartel theory, Leegin's independent interest as a manufacturer was to have its retailers sell its products with the lowest margin consistent with effective marketing of its products, which is entirely consistent with Leegin's effort to establish a retail price floor to encourage service competition among its dealers.

B. PSKS Has Utterly Failed To Respond To Leegin's Arguments Supporting Certiorari.

As noted above, PSKS provides no response to the conflict between the rule of *Dr. Miles* and the treatment of vertical restraints in this Court's modern cases, including *Sylvania* and *Sharp*. In addition, PSKS has not even attempted to respond to a number of other arguments set forth in Leegin's petition that strongly support reviewing the decision below and overturning the rule of *Dr. Miles*.

1. PSKS does not dispute Leegin's argument that there are substantial procompetitive uses of resale price maintenance—an argument that was echoed in the *amicus curiae* brief submitted by 25 distinguished economists. *See* Brief of *Amici Curiae* Economists at 4-11. PSKS likewise fails to provide any analysis grounded in economics to suggest that resale price maintenance "would always or almost always tend to restrict competition and decrease output." *Broadcast Music, Inc.*, 441 U.S. at 19-20.[5]

[Footnote continued from previous page]

cused of facilitating its own injury." *R.J. Reynolds Tobacco Co. v. Cigarettes Cheaper!*, 462 F.3d 690, 696-97 (7th Cir. 2006).

[4] *See* Expert Report of Kenneth G. Elzinga ("Elzinga Report") at 13-15 (Pet. App. at 30a-32a).

[5] The closest PSKS comes to such an analysis is its attempt to resurrect the long-discredited notion from *Dr. Miles* that "the suppression of

Instead, PSKS attempts to invoke a novel standard for the application of *per se* rules by arguing that there are some "anticompetitive explanations for resale price maintenance" (Opp. at 16-17)—that is, the practice might have anticompetitive effects *in some circumstances*. This proposition, which Leegin does not dispute,[6] does not support imposing a sweeping *per se* prohibition on resale price maintenance. Indeed, the same can be said for vertical territorial restraints, which might *sometimes* have anticompetitive effects but are nevertheless evaluated under the rule of reason. *See Sylvania*, 433 U.S. at 59 ("[w]hen anticompetitive effects are shown to result from particular vertical restrictions they can be adequately policed under the rule of reason"); *Khan*, 522 U.S. at 22 (same). The real issue, under this Court's long-standing requirements for the use of *per se* rules, is whether there is economic support for the proposition that resale price maintenance *almost always* has anticompetitive effects and *almost never* has procompetitive effects. There is none.

2. PSKS does not dispute that the rule of *Dr. Miles* has been subject to substantial academic and judicial criticism. *See* Petition at 6, 10-18; *see also* Brief *Amicus Curiae* of

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[Footnote continued from previous page]

competition among dealers by the manufacturer has the same practical effect as an agreement among the dealers themselves to suppress competition." Opp. at 9. This argument is contrary to the Court's holding in *Sylvania*, 433 U.S. at 58-59, and it has been overwhelmingly rejected by economists and legal scholars. *See, e.g.*, 7 Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law* ¶ 1620d (2d ed. 2004) ("To the extent that *Dr. Miles* rests on the false categorical propositions that resale price maintenance never benefits manufacturers and always has the same effects as an illegal dealer cartel, its ruling is ripe for a reexamination the Supreme Court has never given it."); Robert H. Bork, *The Antitrust Paradox* 298 (1978) ("This field of law can be made clear, internally consistent, and congruent with reality only when we face the fact that the premise laid down in *Dr. Miles*—that the vertical elimination of dealer rivalry has the same effect as a horizontal cartel—is incorrect and must be rejected.").

[6] *See* Petition at 16; Elzinga Report at 12-21 (Pet. App. at 29a-38a).

CTIA – The Wireless Association at 5-7; *cf. Sylvania*, 433 U.S. at 47-48 (noting that the "great weight of scholarly opinion ha[d] been critical" of *Schwinn*). In response to the mountain of literature criticizing the *per se* rule against resale price maintenance, PSKS has not identified a single source that either argues for retaining the *per se* rule in its current form or suggests that anticompetitive effects invariably arise when a small manufacturer like Leegin uses resale price maintenance. To the contrary, the very sources cited by PSKS advocate *overturning* the *per se* rule of *Dr. Miles*. For example, PSKS cites an article by Professor F.M. Scherer as purported support for retaining the rule of *Dr. Miles*. Opp. at 16. But Professor Scherer's article does not support such a position. To the contrary, the article states that "[m]y own view has long been that vertical restraints are benign or efficiency enhancing more often than not, leading me to recommend that a rule of reason be applied." F.M. Scherer, *Comment on Cooper et al.'s "Vertical Restrictions and Antitrust Policy,"* Competition Policy Int'l, Autumn 2005, at 65, 74 n.30.[7]

It is also significant to note that Professor Scherer is one of the economists who submitted a brief as *amici curiae* urg-

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[7] The other articles cited by PSKS are similarly unsupportive of the sweeping *per se* rule for which PSKS advocates. *See, e.g.*, Robert L. Steiner, *The Evolution and Applications of Dual-Stage Thinking*, 49 Antitrust Bull. 877, 899 (2004) (arguing that "antitrust intervention against firms that have adopted vertical price or distribution restraints must be confined to brands that enjoy a very strong consumer franchise"); William S. Comanor, *Vertical Price-Fixing, Vertical Market Restrictions and the New Antitrust Policy*, 98 Harv. L. Rev. 983, 1001-02 (1985) ("[I]n the case of new products or products of new entrants into the market, vertical restraints . . . should be permissible, or at least should be treated more leniently in [a] . . . rule of reason analysis."); Robert Pitofsky, *In Defense of Discounters: The No-Frills Case for a* Per Se *Rule Against Vertical Price Fixing*, 71 Geo. L.J. 1487, 1495 (1983) (suggesting that there should be "exceptions to a *per se* rule" or a "'characterization' step" in which a court determines whether to apply the rule of reason or a *per se* rule based on the circumstances of a given case).

ing the Court to grant Leegin's petition and overturn the *per se* rule against resale price maintenance. As that brief explains, there is a disagreement among economists as to whether vertical restraints are always benign or whether they may sometimes lead to anticompetitive effects and therefore should not be viewed as universally procompetitive. *See* Brief of *Amici Curiae* Economists at 15-16. That disagreement in no way supports continued *per se* treatment of resale price maintenance. As the *amici* economists note, there is no support in the literature for the proposition that resale price maintenance most often, much less almost invariably, leads to anticompetitive effects. *Id.* at 16.

C. PSKS's Arguments Are Insufficient To Support Denying Review Or Retaining The Rule Of *Dr. Miles*.

1. PSKS argues that this case does not raise an important issue because federal and state antitrust enforcers have brought "extraordinarily few" challenges to resale price maintenance in recent years and because few private cases have resulted in verdicts for the plaintiffs. Opp. at 9-10. But PSKS is incorrect in equating the number of government challenges or plaintiffs' verdicts with the "everyday importance" of overturning the rule of *Dr. Miles*. Such cases are infrequent because the *per se* rule of *Dr. Miles* deters many businesses from engaging in this efficiency-enhancing practice (Petition at 22-23), there are powerful incentives for manufacturers to settle any cases that are brought (*id.* at 29-30), and, despite the *per se* rule, government enforcers have generally exercised their discretion not to prosecute the practice where it does not harm consumers. That this case provides the Court with a rare opportunity to reconsider the rule of *Dr. Miles* only augments its cert-worthiness.

Similarly, while PSKS is correct that the *Colgate* doctrine and *Sylvania*'s rule-of-reason treatment for vertical nonprice restraints provide a measure of "freedom to companies to lawfully arrange their businesses to achieve permissible economies" (Opp. at 10), there is no rational reason why companies should be prevented from achieving similar

economies through vertical price restraints. Petition at 13-14; *see also* Brief *Amicus Curiae* of the Nat'l Ass'n of Mfrs. at 11-12. Retaining the *per se* rule against just one type of vertical restraint merely burdens businesses that could more efficiently compete through vertical price restraints, and it creates an unwarranted trap for companies that attempt to establish a *Colgate* policy but inadvertently stray across the line into an agreement, as occurred in this case.

2. PSKS's argument that resale price maintenance should remain *per se* unlawful because this Court should always "safeguard practices that result in lower consumer prices" (Opp. at 20) is flat wrong as a matter of both law and economics. First, as a matter of economics, the modern economic understanding of vertical restraints demonstrably shows that vertical restraints can enhance efficiency and benefit consumers by fostering interbrand competition, even if they result in higher prices to consumers. *See* Petition at 11-14; Brief of *Amici Curiae* Economists at 11-12. Second, as a matter of law, this Court has long recognized that vertical restraints that result in increased retail prices can enhance interbrand competition and consumer welfare. Indeed, as the Court explained in *Sharp*, that is precisely why vertical nonprice restraints were held to be subject to the rule of reason in *Sylvania*. 485 U.S. at 728 ("[V]ertical nonprice restraints only accomplish the benefits identified in *GTE Sylvania* because they reduce intrabrand price competition to the point where the dealer's profit margin permits provision of the desired services."). The effect on retail prices and interbrand competition that justified rule-of-reason treatment in *Sylvania* simply cannot be used to justify *per se* treatment here.

3. PSKS also contends that there has been congressional support for retaining the rule of *Dr. Miles*. Opp. at 11-15. As Leegin pointed out in its petition, however, Congress has never passed legislation requiring that resale price maintenance be treated as *per se* unlawful, and it has never taken away this Court's power to interpret the antitrust laws or define the *per se* rules that the Court has created. *See* Petition at 26-27. PSKS does not respond to these points.

Instead, PSKS quotes from a 1991 House Report in connection with legislation that never passed. Opp. at 11-12. Similarly, PSKS quotes from dicta in this Court's opinion in *Sylvania* and Justice Brennan's concurrence in *Monsanto* (Opp. at 11, 14), but the viability of the rule of *Dr. Miles* was not before the Court in either of those cases.[8] The passages quoted by PSKS are obviously no substitute for actual legislation from Congress mandating *per se* treatment of resale price maintenance—which does not exist.

PSKS also quotes a statement from a meeting of the Antitrust Modernization Commission ("AMC") about the AMC's decision not to study changes to the law of resale price maintenance. Opp. at 13-14.[9] Obviously, such a statement is not the equivalent of legislation from Congress. The AMC is not a legislative body; it was instead granted limited authority to study issues and prepare a report. *See* Pub. L. No. 107-273, § 11053, 116 Stat. 1758, 1856 (2002). Moreover, the AMC, which has not issued a formal report, has taken no position on the propriety of the rule of *Dr. Miles*.

Apparently recognizing that Congress has never mandated adherence to the rule of *Dr. Miles*, PSKS falls back on the notion of Congress's "positive inaction." Opp. at 15. PSKS fails to note, however, that this Court emphatically re-

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[8] PSKS incorrectly asserts that "[o]n several occasions" the Court has "reconsidered" and "reaffirmed" the *per se* rule against resale price maintenance. Opp. at 2. To the contrary, the Court has not considered the viability of this rule in *Sylvania*, *Sharp*, *Monsanto*, *Khan*, or any other recent case. To the extent the Court referred to the rule of *Dr. Miles* in any of those cases, it was simply describing the state of the law, not making an advisory ruling that the rule should be preserved in perpetuity.

[9] In discussing the AMC's decision, PSKS curiously omits mention of the report of the working group that assessed whether the AMC should study whether "resale price maintenance [should] be defined legislatively as a Rule of Reason offense." AMC Working Group Mem. 14 (Dec. 21, 2004), *at* http://www.amc.gov/pdf/meetings/Single-FirmConduct.pdf. That report recommended that the AMC not study the issue, but instead "stand aside and let the common law process work." *Id.* at 16.

jected the same argument from the respondents in *Khan*, who cited the same cases as does PSKS. *See Khan*, 522 U.S. at 19 (explaining that the decisions regarding the antitrust exemption for professional baseball "are clearly inapposite," and "infer[ring] little meaning from the fact that Congress has not reacted legislatively to *Albrecht*"). As the Court explained in *Khan*, "the general presumption that legislative changes should be left to Congress has less force with respect to the Sherman Act in light of the accepted view that Congress expected the courts to give shape to the statute's broad mandate" and to reevaluate previous interpretations undermined by the passage of time. *Id.* at 20.

4. Finally, PSKS asserts that "general principles of *stare decisis* counsel against revisiting the *Dr. Miles* rule." Opp. at 20. PSKS, however, omits any mention of either the Court's treatment of this issue in *Khan*, in which the Court rejected the same argument that PSKS now raises, or the long line of cases in which this Court has emphasized the dynamic nature of the Sherman Act and the role of the Court in adapting the law to "the lessons of accumulated experience." *Khan*, 522 U.S. at 21; *see also* Petition at 24-25.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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